STATEMENT OF DUANE BANDEROB
LEPRINO FOODS COMPANY
at the
UNITED STATES DEPARTMENT OF AGRICULTURE PUBLIC HEARING

In the Matter of Milk in the Central Marketing Area
Docket Nos.: AO-313-A44; DA-01-07
Kansas City, Missouri
November 15, 2001

Introduction

I am Duane Banderob, Dairy Economist for Leprino Foods Company (Leprino), the position I have held for the past two years. My employment with Leprino was preceded by work in a milk processing plant as well as completing degrees in dairy science at the California Polytechnic State University at San Luis Obispo and agricultural economics at Michigan State University. Leprino is headquartered in Denver, Colorado. Our business address is 1830 West 38th Avenue, Denver, Colorado 80211-2200. Leprino operates eleven plants in the United States, manufacturing mozzarella cheese and whey products domestically and marketing our products both domestically and internationally. Our cheese is primarily used as an ingredient by major pizza chains, independent pizza restaurants, as well as many of the nation's leading food companies. Leprino operates four manufacturing facilities that receive milk regulated by the Central Order. These facilities are located in Fort Morgan, Colorado, and Dodge, Hartington, and Ravenna, Nebraska.

I am testifying today in opposition to proposal number 6, the proposal to increase the partial payment rate from the lowest Class price for the preceding month, to 110% (105%) of that price.

The proponents of proposal 6 point to producer cash flow challenges that exist due to the disparity between the level of the partial payment and the level of the final payment. We do not contest this concern regarding producer cash flow. However, the root cause of the price disparity between the partial payment and the final payment is the lack of blending the higher values of milk into the partial payment. The proposed remedy does not address this issue, but rather simply transfers the cash flow burden to processors. The result of the proposal is that manufacturers of products in the lowest Class, and in many months in the lowest two Classes, will pay more than the classified value of their milk in the partial payment. This violates the minimum pricing intent of the Orders. Additionally, the application of the proponent's logic

across several Orders results in inequities in the form of different partial payments amongst competitors in manufactured product markets.

Issue

The source of the differences between the partial payment and the final payment is two-fold. First, the partial payment is based on the prior month's rather than the current month's market value. Second, the partial payment does not capture the incremental value contributed to the final payment by utilizations with higher classified values than the lowest Class price. This incremental value is captured for the final payment through the pooling process administered by the Market Administrator.

The first source of difference, the use of prior month rather than current month market values in setting the minimum partial payment, is generally not referenced as a concern since the resulting partial payment is sometimes above, and sometimes below current month market values. To the extent that a concern exists, the processor obligation for the partial payment could be updated to current month market values. Since not all market values for the full month are known at the time of the partial payment, the partial payment could be calculated based on the factors for that portion of the month for which the data has been published prior to the partial payment deadline. This additional calculation and announcement would require additional administration due to the additional price calculations and the necessary communication to market participants.

The second and more important source of difference between the partial payment and final payment is the absence of contribution of the incremental value from the higher Classes of milk in the partial payment. Although they have not explicitly characterized it as such, this appears to be of primary concern to the proponents of proposal 6.

Analysis

Proposal 6 fails to address either of the sources of differences between the partial and final payment prices. The proposal does not result in an increased correlation between the partial payment and the final payment. Analysis of the period from January 2000 through October 2001 is shown in Attachment 1. Key observations over this period are that had proposal 6 been in place, the partial payment price is increased by $1.11 (56¢) per cwt., which reduces the average shortfall of the partial payment relative to the blend price from $1.59 to 48¢ ($1.04) per cwt. However, the monthly differences between the partial payment and blend price range from an "underpayment" of $1.95 ($2.38) to an "overpayment" of $2.23 ($1.45), a clear indication that the proposal does not emulate the final payment. The standard deviation of the differences between the partial payment and the blend price also increases from 78¢ under the current system to 89¢ (83¢) per cwt. under proposal 6.

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Violation of Basic Tenets of Minimum Manufacturing Prices

The proposal violates two basic tenets of pricing for milk manufactured into Class III and IV products. These are that Federal Milk Marketing Orders establish minimum prices, and that since manufactured products are marketed nationally, the minimum regulated price level for Classes III and IV are consistent across all Orders.

Proposal 6 violates the minimum pricing concept by setting regulated milk prices for the partial payment above the equivalent market value for Classes III and IV. For example, during the period from January 2000 through September 2001, the minimum partial payment obligation would have exceeded the Class III price by 73¢ (19¢) per cwt. on average.

The proponents of proposal 6 are advocating similar provisions in other Orders. However, the factor that is being proposed is different for different Orders, resulting in disparate economic positions for competing Class III and IV manufacturers located in different Orders. For example, the proposed factor in the Upper Midwest Order is 103%, which would result in an average partial payment price that is about 78¢ (22¢) per cwt. lower than that proposed for the Central Order.

Conclusion

The logical conclusion from the above analysis is that the most appropriate approach to address the root cause of the disparity between the level of the partial and final payment is to implement a similar minimum payment and pooling structure for the partial payment that currently exists for the final payment. Although this is the logical remedy, I am not proposing that it be adopted at this time. This remedy would require significant additional administration in terms of plant reporting, report analysis, pool calculation, and movement of funds into and out of the pool than the current system of minimum payment at the lowest Class price. Additionally, such an approach would significantly impact many handlers who are not participating in the hearing today, since the concept was not properly noticed. A more comprehensive review of all provisions of the Orders that would be impacted and the associated impacts would also be necessary prior to serious consideration of such an approach.

Although we are sympathetic to the issue of concern that is cited by proponents of proposal 6, we do not agree that the proposed solution is appropriate or equitable. Although I have outlined a more appropriate approach to addressing the concern, that approach should not be considered a proposal as part of this rulemaking process since it has not been properly noticed. USDA should reject proposal 6 since it does not appropriately address the issue it purports to remedy, and it violates the minimum pricing concepts for manufacturers.

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Comparison of Partial Payment Prices under Current System and Proposal 6 at 110% to Blend Prices

(All numbers in $/cwt)

Month	Prior Month Class III Price	Prior Month Class IV Price	(A) Current Partial Payment Price [1]	(B) Proposal 6 Partial Payment Price [2]	(B) less (A) Proposal 6 Price less Current Price	(C) Central Order Blend Price	(A) less (C) Current Price less Blend Price	(B) less (C) Proposal 6 Price less Blend Price
Jan-00	9.63	10.69	9.63	10.59	0.96	11.23	(1.60)	(0.64)
Feb-00	10.05	10.73	10.05	11.06	1.01	11.00	(0.95)	0.06
Mar-00	9.54	10.80	9.54	10.49	0.95	10.91	(1.37)	(0.42)
Apr-00	9.54	11.00	9.54	10.49	0.95	10.84	(1.30)	(0.35)
May-00	9.41	11.38	9.41	10.35	0.94	10.96	(1.55)	(0.61)
Jun-00	9.37	11.91	9.37	10.31	0.94	11.16	(1.79)	(0.85)
Jul-00	9.46	12.38	9.46	10.41	0.95	11.95	(2.49)	(1.54)
Aug-00	10.66	11.87	10.66	11.73	1.07	11.61	(0.95)	0.12
Sep-00	10.13	11.87	10.13	11.14	1.01	11.97	(1.84)	(0.83)
Oct-00	10.76	11.94	10.76	11.84	1.08	11.40	(0.64)	0.44
Nov-00	10.02	11.81	10.02	11.02	1.00	10.85	(0.83)	0.17
Dec-00	8.57	13.00	8.57	9.43	0.86	11.38	**(2.81)**	**(1.95)**
Jan-01	9.37	13.27	9.37	10.31	0.94	11.85	(2.48)	(1.54)
Feb-01	9.99	12.13	9.99	10.99	1.00	11.82	(1.83)	(0.83)
Mar-01	10.27	12.70	10.27	11.30	1.03	12.74	(2.47)	(1.44)
Apr-01	11.42	13.46	11.42	12.56	1.14	13.42	(2.00)	(0.86)
May-01	12.06	14.41	12.06	13.27	1.21	14.80	(2.74)	(1.53)
Jun-01	13.83	15.04	13.83	15.21	1.38	15.79	(1.96)	(0.58)
Jul-01	15.02	15.33	15.02	16.52	1.50	16.14	(1.12)	0.38
Aug-01	15.46	14.81	14.81	16.29	1.48	16.29	(1.48)	0.00
Sep-01	15.55	15.06	15.06	16.57	1.51	16.56	(1.50)	0.01
Oct-01	15.90	15.59	15.59	17.15	1.56	14.92	**0.67**	**2.23**
Mean 2000	9.76	11.62	9.76	10.74	0.98	11.27	(1.51)	(0.53)
YTD 2001	12.89	14.18	12.74	14.02	1.27	14.43	(1.69)	(0.42)
Period Mea	11.18	12.78	11.12	12.23	1.11	12.71	(1.59)	(0.48)
Period Standard Deviation							0.78	0.89

[1] Partial payment price is the lowest announced class price from the preceding month.

[2] Partial payment rate is 110 percent of the lowest announced class price from the preceding month.

Comparison of Partial Payment Prices under Current System and Proposal 6 at 105% to Blend Prices

(All numbers in $/cwt)

Month	Prior Month Class III Price	Prior Month Class IV Price	(A) Current Partial Payment Price [1]	(B) Proposal 6 Partial Payment Price [2]	(B) less (A) Proposal 6 Price less Current Price	(C) Central Order Blend Price	(A) less (C) Current Price less Blend Price	(B) less (C) Proposal 6 Price less Blend Price
Jan-00	9.63	10.69	9.63	10.11	0.48	11.23	(1.60)	(1.12)
Feb-00	10.05	10.73	10.05	10.55	0.50	11.00	(0.95)	(0.45)
Mar-00	9.54	10.80	9.54	10.02	0.48	10.91	(1.37)	(0.89)
Apr-00	9.54	11.00	9.54	10.02	0.48	10.84	(1.30)	(0.82)
May-00	9.41	11.38	9.41	9.88	0.47	10.96	(1.55)	(1.08)
Jun-00	9.37	11.91	9.37	9.84	0.47	11.16	(1.79)	(1.32)
Jul-00	9.46	12.38	9.46	9.93	0.47	11.95	(2.49)	(2.02)
Aug-00	10.66	11.87	10.66	11.19	0.53	11.61	(0.95)	(0.42)
Sep-00	10.13	11.87	10.13	10.64	0.51	11.97	(1.84)	(1.33)
Oct-00	10.76	11.94	10.76	11.30	0.54	11.40	(0.64)	(0.10)
Nov-00	10.02	11.81	10.02	10.52	0.50	10.85	(0.83)	(0.33)
Dec-00	8.57	13.00	8.57	9.00	0.43	11.38	**(2.81)**	**(2.38)**
Jan-01	9.37	13.27	9.37	9.84	0.47	11.85	(2.48)	(2.01)
Feb-01	9.99	12.13	9.99	10.49	0.50	11.82	(1.83)	(1.33)
Mar-01	10.27	12.70	10.27	10.78	0.51	12.74	(2.47)	(1.96)
Apr-01	11.42	13.46	11.42	11.99	0.57	13.42	(2.00)	(1.43)
May-01	12.06	14.41	12.06	12.66	0.60	14.80	(2.74)	(2.14)
Jun-01	13.83	15.04	13.83	14.52	0.69	15.79	(1.96)	(1.27)
Jul-01	15.02	15.33	15.02	15.77	0.75	16.14	(1.12)	(0.37)
Aug-01	15.46	14.81	14.81	15.55	0.74	16.29	(1.48)	(0.74)
Sep-01	15.55	15.06	15.06	15.81	0.75	16.56	(1.50)	(0.75)
Oct-01	15.90	15.59	15.59	16.37	0.78	14.92	0.67	1.45
Mean 2000	9.76	11.62	9.76	10.25	0.49	11.27	(1.51)	(1.02)
YTD 2001	12.89	14.18	12.74	13.38	0.64	14.43	(1.69)	(1.05)
Period Mea	11.18	12.78	11.12	11.67	0.56	12.71	(1.59)	(1.04)
Period Standard Deviation							0.78	0.83

[1] Partial payment price is the lowest announced class price from the preceding month.

[2] Partial payment rate is 105 percent of the lowest announced class price from the preceding month.